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Even California Non-Residents Can Face California Taxes



Many people have left California in recent years, and some of them can tell you that [leaving California taxes behind is tricky](#). Some people seem to exit the Golden State shortly before a big income event, and as a result, [California's tax agency likes to check on "move then sell" fact patterns](#). Timing matters a lot. More generally, even if you are--are were always--a non-resident of California, you are still taxable on your California-source income. Many people are surprised that [California's tax collector collects from nonresidents](#).

Move Then Sell?

Most capital gains, interest, and dividends from intangible assets (stocks, bonds, etc.) are not California-source income if the income is received when you are a non-resident. Of course, the sale must occur after you have established residency in a new state, but California law is less clear about *when* a sale is considered to have occurred for tax purposes. Clearly, if you have already received the sales proceeds, the sale has occurred.

When Does a Sale Occur?

However, some federal tax authorities suggest that the sale can be considered as having occurred *before* you receive the sales proceeds. It can occur when there is a meeting of the minds on the material terms of the sale, and there is some indication that California also adopts this view. For example, if a sale is structured to have installment payments, if the original sale occurs while you are a California resident, then *all* installments from the sale will be California-source income, even if you are no longer a resident when you receive the later installments.

If a binding term sheet or sales agreement has already been signed, the FTB could argue that the sale has effectively already occurred for tax purposes,

even if you have not yet been paid. So even though a term sheet may expressly say it is nonbinding, it is safer to move before a term sheet is signed.

Capital Gain & Rental Income from Real Estate & Tangible Property

Income produced by California real estate is always California-source income. Income produced by tangible property is California-source income when the property was physically located inside of California at the time of sale.

Wages and Compensation for Services

Wages and other compensation for services are generally sourced to the location where you perform the services. Therefore, if you spend 30% of your working time working from California, then 30% of your salary should be California-source income. If you are planning to work partially from California, you should discuss with your employer how they would prefer for you to keep your time. It is also good to inquire what sort of California payroll taxes and withholdings should be imposed on the California portion of your wages and compensation.

Stock Options, RSUs, and Other Equity-based Compensation

Equity-based compensation is still compensation for services. Therefore, if you are a California non-resident when you recognize the income for tax purposes, the income is sourced to the location where you provided the services that earned the equity-based compensation. It is possible that the equity-based compensation was granted when you were a resident of California, but did not fully vest or was not exercised until after you left California.

California law does not provide a required formula for allocating income from equity-based compensation between California-source and non-California-source income, but only requires that the allocation be reasonable.

Nevertheless, it appears to be reasonable to allocate the income based on time spent in California.

For *nonqualified* stock options, it should generally be acceptable to allocate the income generated upon the exercise of the option based on the number of days working in California versus the number of days working outside of California between the date of grant and the date of *exercise*. There are some authorities suggesting that it may also be reasonable to allocate the income generated by exercising the option by looking at the period between the date of grant and the date of *vesting* (instead of the date of *exercise*).

This same standard is also generally used for restricted stock units and other equity-based deferred compensation. If you perform the majority of your work in California and move immediately before exercising an option or immediately before RSUs vest, most of the income from the exercise or vesting of the deferred compensation may still be taxable in California.

For incentive stock options (ISOs), under federal tax law there is no wage portion. Instead, the incentive stock option is only taxed as capital gain when sold (assuming you hold the shares received for the required amount of time before selling them). California law conforms to the federal rule. Therefore, ISOs do not generally result in California tax (other than potentially for AMT purposes) when exercised. Moreover, because capital gain from the sale of shares is generally sourced to the residency of the owner, there may not be California-source income when you later sell the shares received from the exercise of the ISO.

Pensions, 401(k)s, and IRAs

Pensions and other retirement benefits could also be viewed as compensation for services you previously performed, perhaps while you were a California resident. Fortunately, though, California law generally treats these retirement payments as *not* California-source income when received by a non-resident.